89-1180

No. -

Supreme Court, U.S.
FILED
JAN 18 1990
JOSEPH F. SPANIOL, JR.
CLERK

In the
Supreme Court of the United States

OCTOBER TERM, 1989

MICHAEL D. BARRETT AND
G. LAMAR CRITTENDEN, JR.,
PETITIONERS,

v.

CONTINENTAL ILLINOIS NATIONAL BANK
AND TRUST COMPANY OF CHICAGO,
RESPONDENT.

Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

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January 18, 1990

BATEMAN & SLADE, INC. BOSTON, MASSACHUSETTS

Question Presented.

The District Court judge at a trial without a jury admitted into evidence transcripts of the deposition testimony of two unavailable out-of-state witnesses. Without reading or in any way considering this testimony, the trial judge dismissed the case, stating that "plaintiff has failed to prove that the company had an unreasonably small capital at a crucial time." On appeal, the Court of Appeals held that the trial judge, as fact-finder, had made a finding of fact, which was not clearly erroneous.

The question presented is whether the District Court judge, as fact-finder, was prohibited from making determinative findings of fact on issues at trial without first considering relevant and material evidence introduced at trial, bearing on those issues.

Table of Contents

Question presented	i
Opinions below	2
Jurisdiction	2
Constitutional provision involved	2
Statement of the case	3
Reasons for granting the writ	8
1. Due process of law requires the factfinder to hear the evidence before finding the facts	8
2. The proceedings in the case at bar undermine confidence in the judicial process	10
3. Appellate review for clear error did not render the error harmless	12
4. The error is determinable from the record	13
5. The evidence not considered bore on the subject matter of the findings	13
6. The issue presented to this Court was timely raised to the First Circuit	14
Conclusion	17
Appendix	follows page 17

Table of Authorities Cited.

CASES.

Baltimore & O. R. Co. v. *United States*, 298 U.S. 349 (1936)	9
Barrett v. *Continental Illinois Nat. Bank & Trust*, 882 F.2d 1 (1st Cir. 1989)	*passim*

Boddie v. *Connecticut*, 401 U.S. 371 (1971) 10, 11

Crawford v. *Northeastern Oklahoma State University*, 713 F.2d 586 (10th Cir. 1983) 15

D.P. Apparel Corp. v. *Roadway Express, Inc.*, 736 F.2d 1 (1st Cir. 1984) 15

Hartford Fire Ins. Co. v. *Lawrence, Dykes, Goodenberger, Bower & Clancy*, 740 F.2d 1362 (6th Cir. 1984) 10

Hoover v. *Ronwin*, 446 U.S. 558 (1984) 16

Jefferson Fourteenth Assoc. v. *Wometco de Puerto Rico*, 695 F.2d 524 (11th Cir. 1983) 10

Marshall v. *Jerrico, Inc.*, 446 U.S. 238 (1980) 8

Mathews v. *Eldridge*, 424 U.S. 319 (1976) 16

Morgan v. *United States*, 298 U.S. 468 (1936) 8, 9

Mullane v. *Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950) 10

Pierce v. *Underwood*, 487 U.S. 552, 108 S.Ct. 2541 (1988) 12

Ray v. *Foreman*, 441 F.2d 1266 (6th Cir. 1971) 15

United States v. *Crescent Amusement Co.*, 323 U.S. 173 (1944) 12

United States v. *Forness*, 125 F.2d 928 (2d Cir. 1942) 12

United States v. *United States Gypsum Co.*, 333 U.S. 364 (1948) 12

STATUTE.

Massachusetts General Laws c. 109A, § 5 3

RULES.

Fed. R. App. P. Rule 28(b) 15
Fed. R. Civ. P. Rule 41(b) 15

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RESPONDENT.

Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

Now come the petitioners, Michael D. Barrett and G. Lamar Crittenden, Jr., and respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the First Circuit entered in Case No. 89-1151 on August 10, 1989, as to which rehearing was denied on October 20, 1989.

Opinions Below.

The opinion of the United States Court of Appeals for the First Circuit is reported at 882 F.2d 1 and appears in the appendix to this petition at App. 1, *infra*. The order denying rehearing and rehearing *en banc* is not reported and appears in the appendix at App. 17.

The oral decision of the United States District Court for the District of Massachusetts (Caffrey, S.D.J.) is not reported and appears in the appendix at App. 15.

Jurisdiction.

On February 3, 1989, the District Court judge orally allowed an oral motion to dismiss made by respondent pursuant to Fed. R. Civ. P. Rule 41(b) at the conclusion of petitioners' evidence (App. 15). Judgment for respondent was entered on February 7, 1989 (App. 18), and petitioners appealed on February 8, 1989. On August 10, 1989, the Court of Appeals for the First Circuit entered a judgment (App. 16) and an opinion (882 F.2d 1, App. 1) affirming the judgment of the District Court. On August 23, 1989, petitioners filed a Petition for Rehearing with a Suggestion for Rehearing In Banc. By an order dated October 20, 1989 the Petition for Rehearing and Suggestion for Rehearing In Banc were denied (App. 17).

The jurisdiction of this Court to review the judgment of the Court of Appeals for the First Circuit is invoked pursuant to 28 U.S.C. § 1254(1).

Constitutional Provision Involved.

United States Constitution, Amendment V: "No person shall . . . be deprived of life, liberty, or property, without due process of law. . . .

Statement of the Case.

The petitioners brought this action in the Suffolk County Massachusetts Superior Court. The action was removed to the United States District Court for the District of Massachusetts by respondent pursuant to 28 U.S.C. § 1441 citing original jurisdiction of the District Court under 28 U.S.C. § 1332(a) because of diversity of citizenship.

The case concerns an alleged fraudulent conveyance of two million dollars by Eastern Capital Corporation to respondent, Continental Illinois National Bank and Trust Company on May 16, 1984. At a two-day trial in February, 1989, petitioners, Michael D. Barrett and G. Lamar Crittenden, Jr., sought to prove that at the time of the transfer they were creditors of Eastern, and that the conveyance had been without consideration and had left Eastern with an "unreasonably small capital" within the meaning of Section 5 of the Uniform Fraudulent Conveyance Act (Massachusetts General Laws, c. 109A, § 5).*

As part of their evidence at trial, Barrett and Crittenden introduced into evidence the transcripts of and exhibits at the depositions of two unavailable out-of-state witnesses. One witness was Stanley Z. Finer, a vice-president of Continental, who had helped arrange the transfer as a partial payment of a bad loan made to one of the owners of Eastern's parent company. His testimony covers 140 pages and seven exhibits are identified. The other witness was William R. Van der Weele, who had served as president and chief financial officer of Eastern up to February, 1984 who, during the spring of 1984, had

* Section 5 of the Uniform Fraudulent Conveyance Act (M.G.L. c. 109A, § 5) provides:

> Every conveyance made without fair consideration when the person making it is engaged or is about to engage in a business or transaction, for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent as to creditors . . . without regard to his actual intent.

prepared or helped prepare pertinent regulatory reports reflecting Eastern's financial condition. Van der Weele's testimony covers 116 pages, and nine exhibits are identified.

The transcripts of the deposition testimony of these two witnesses were admitted unread into evidence on the afternoon of the second day of trial. Immediately following introduction of the deposition transcripts and exhibits, a witness named Rupert Francis testified briefly (his testimony is transcribed on 28 pages). After a five-minute recess,* the next witness, Alexa Lewis, testified briefly (8 pages).

After the testimony of Alexa Lewis, Barrett and Crittenden rested their case. Without any break, Continental made an oral motion for dismissal pursuant to Fed. R. Civ. P. Rule 41(b) (App. 11). Continental argued that Barrett and Crittenden had not "made out a case" because Eastern's capital deficiency in May had been cured in June and because the action was barred by dismissal of a prior suit. In response, Barrett and Crittenden argued that the capital deficiency had not been cured in June, that any cure was part of a liquidation plan as "you will see when you read Mr. Finder's [*sic*] transcript", that reasonableness of capital should not be assessed in June when Eastern ceased business, and that dismissal of the prior case did not bar this action (App. 14). Without leaving the bench, the District Court judge summarily allowed the motion (App. 15):

> The motion is allowed on the grounds that Mr. Johnson spelled out: First of all, the plaintiff has failed to prove that the company had an unreasonably small amount of capital at a crucial time. Secondly,

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*The five-minute recess is reflected in the trial transcript as follows:

> Mr. Whiteside: My next witness is Alexa Lewis.
> The Court: Let's take five minutes before you start.
> (Recess).

> on res judicata, this has been litigated once. You can't relitigate it. So the Motion for Judgment for the Defendant is allowed.

It thus appears that prior to dismissing the case the District Court judge had no opportunity to read the deposition evidence.* In the Statement of Proceedings of their brief on appeal, Barrett and Crittenden set out the trial judge's failure to read the deposition evidence as follows (Brief at page 28):

> Following conclusion of Alexa Lewis' testimony plaintiffs rested and Continental orally moved for dismissal (App. 276). Without having first read the Finer and Van der Weele depositions, the trial court allowed the motion, ruling that plaintiffs had failed to prove that Eastern had an "unreasonably small capital at a crucial time" and that res judicata barred maintenance of the action (App. 282).

In their brief, Barrett and Crittenden framed the two issues on appeal to be issues of law (i.e., whether the plaintiffs had failed to prove unreasonably small capital and whether res judicata barred the action) (Brief at page i). Petitioners argued that Judge Caffrey had mistakenly considered June, 1984, when Eastern had gone out of business, to be a "crucial time" for determining the reasonableness of capital whereas the only "crucial time" under the Uniform Fraudulent Conveyance Act is at or immediately after the time of the allegedly fraudulent

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* At a recorded bench conference on the previous day to discuss the district court's suggestion that the case be settled for $125,000, counsel rejected the suggestion on the basis that Barrett and Crittenden wanted the judge first to review the deposition testimony. Counsel proposed that Judge Caffrey read the depositions overnight, a proposal which was rejected: ("I am not doing homework on this case, believe me. Tonight is my tennis night as a matter of fact.")

conveyance (Brief at pages 38-43). They then argued that the evidence showed capital to be unreasonably small immediately after the transfer on May 16, 1984 (Brief at pages 43-47) and concluded that Eastern's financial condition in June or July was irrelevant (Brief at pages 47-50).

In its brief on appeal Continental included an argument that "[t]he district court's finding that Barrett and Crittenden failed to prove that Eastern Capital had an unreasonably small capital under Section 5 of the UFCA is a finding of fact", and that this "finding cannot be reversed on appeal unless it is found to be clearly erroneous. Fed. R. Civ. P. 52(a)".

In an argument entitled "*The Trial Court Did Not Find the Facts in Ruling that Plaintiffs Had Failed to Establish Unreasonably Small Capital at a Crucial Time But Rather Made a Conclusion of Law Subject to This Court's Review As Such*", Barrett and Crittenden devoted five pages of a Reply Brief in response to Continental's argument that the District Court had made a finding of fact. They made the following assertion (Reply Brief at page 1):

> The record does not support this view that the dismissal resulted from factual determinations adverse to plaintiffs. In fact, the trial court made the ruling without first reading the depositions of Stanley Finer or William Van der Weele (Exhibits 17 and 18) and, thus, could not have been making a determination upon consideration of all the facts. . . .

In the Reply Brief, Barrett and Crittenden likened the case to another decided by the same trial judge (Reply Brief at pages 2-3):

> The ruling in the case at bar is similar to the ruling reviewed by [the First Circuit] in *D.P. Apparel Corp.*

> v. *Roadway Express., Inc.*, 736 F.2d 1, 3 (1st Cir. 1984) where District Judge Caffrey had allowed a Rule 41(b) motion for involuntary dismissal because of plaintiff's failure to sustain its burden of proof of a *prima facie* case. [The First Circuit] stated that a district court has the inherent power to dismiss cases for failure to prove a claim (736 F.2d at 3-4). . . .

In an opinion by Judge Reinhardt (sitting by designation), the First Circuit stated that it agreed with Continental's argument "that inasmuch as the proceeding below was a bench trial with the judge filling the factfinder's role, [the First Circuit] should consider [Judge Caffrey's conclusion] to be basically a factual finding, subject to review only for clear error". The First Circuit recast Barrett and Crittenden's position on appeal to be that the District Court must have clearly erred because Eastern's apparent insolvency on the date of the transfer would have necessarily constituted an unreasonably small capital at that time. The court rejected such a position and held that there was ample evidence in the "full record" on the basis of which the District Court could have concluded that, as a matter of fact, Barrett and Crittenden had failed to show that Eastern's capital was unreasonably small at a crucial time (882 F.2d at 4-5; App. 6-9).

On August 23, 1989, Barrett and Crittenden timely filed a petition for rehearing, alleging that the First Circuit had overlooked or misapprehended five points, the first of which was:

> I. The District Court, After Admitting Into Evidence Transcripts Of The Depositions Of Out-of-State Witnesses, Erred In Failing To Read That Testimony Prior to Making The Decisive Factual Finding

As to this point, Barrett and Crittenden also suggested a rehearing in banc based on belief that this point concerned "judicial

action threatening the fundamental fairness of the factfinding process." They concluded five pages of supporting argument on this point as follows (Petition for Rehearing at page 5):

> In *Marshall* v. *Jerrico, Inc.*, 446 U.S. 238, 242, 100 S. Ct. 1610, 1613 (1980), the Supreme Court held that "[t]he Due Process Clause entitles a person to an impartial and disinterested tribunal in both civil and criminal cases". A judge, who decides cases without reference to some or all of the evidence before him, is neither. In the case at bar, it was fundamentally unfair, in violation of plaintiffs' rights guaranteed by the Due Process Clause of the Fifth Amendment, for the trial court, sitting without a jury, when confronted with fact-intensive depositions of out-of-state witnesses and related exhibits, to have admitted the depositions into evidence and then to have simply ignored them and decided the case as if the out-of-state witnesses did not exist. . . .

On October 20, 1989, the petition for rehearing and the suggestion for rehearing in banc were denied in an order without opinion (App. 17).

Reasons for Granting the Writ.

THE FIRST CIRCUIT'S DECISION UPHOLDING A FINDING OF FACT BY A JUDGE WHO HAD NOT HEARD ALL OF THE EVIDENCE WAS MADE WITHOUT REGARD TO BASIC REQUIREMENTS OF PROCEDURAL DUE PROCESS AND TO LONG-STANDING DECISIONS OF THIS COURT.

1. *Due Process Requires the Factfinder to Hear the Evidence Before Finding the Facts.*

More than fifty years ago, this Court decided *Morgan* v. *United States*, 298 U.S. 468 (1936) emphatically disapproving

a procedure by which the Secretary of Agriculture allegedly made findings of fact in setting rates without hearing or reading the evidence; this Court, in remanding for a determination whether the plaintiffs had received the "full hearing" required by statute, said (298 U.S. at 480-481):

> A proceeding of this sort requiring the taking and weighing of evidence, determinations of fact based upon the consideration of the evidence, and the making of an order supported by such findings, has a quality resembling that of a judicial proceeding. . . . The requirement of a "full hearing" has obvious reference to the tradition of judicial proceedings in which evidence is received and weighed by the trier of facts. The "hearing" is designed to afford the safeguard that the one who decides shall be bound in good conscience to consider the evidence, to be guided by that alone, and to reach his conclusion uninfluenced by extraneous considerations. . . . The "hearing" is the hearing of evidence and argument. If the one who determines the facts which underlie the order has not considered evidence or argument, it is manifest that the hearing has not been given.

In *Morgan*, this Court did not find it "necessary to go beyond the terms of the statute in order to consider the constitutional requirement of due process as to notice and hearing" (298 U.S. at 477). However, in *Baltimore & O. R. Co.* v. *United States*, 298 U.S. 349, 368-369 (1936), decided a week before *Morgan*, this Court held that in cases where the due process clause of the Fifth Amendment assures a "full hearing", such a "full hearing" includes "the right to introduce evidence and have judicial findings based upon it" (footnotes with citations omitted).

In the case at bar, petitioners, as creditors of Eastern Capital Corporation, claimed a right (established under the laws of Massachusetts) to $2,000,000 transferred by Eastern without consideration to Continental. This cause of action against Continental constituted a species of property, of which the deprivation required procedural due process. See *Jefferson Fourteenth Assoc.* v. *Wometco de Puerto Rico*, 695 F.2d 524, 527 (11th Cir. 1983) ("a party who brings a claim in good faith has a due process right to litigate that claim"); *Hartford Fire Ins. Co.* v. *Lawrence, Dykes, Goodenberger, Bower & Clancy*, 740 F.2d 1362, 1367 (6th Cir. 1984) ("A litigant has no vested property right in a cause of action until it accrues".). Although this Court has never specifically demarcated the minimal procedures required by the Due Process Clause (whether of the Fifth or Fourteenth Amendment) in trial of an ordinary civil case, "there can be no doubt that at a minimum they require that deprivation of life, liberty or property by adjudication be proceeded by notice and opportunity for hearing appropriate to the nature of the case." *Mullane* v. *Central Hanover Bank & Trust Co.*, 339 U.S. 306, 313 (1950).

A hearing appropriate to a disputed, non-frivolous civil case would necessarily include the right for a litigant to have admissible, relevant and material evidence heard by the factfinder. Due process guarantees would have little meaning if the factfinder were permitted to determine factual issues without consideration of relevant portions of the evidence before him.

2. *The Proceedings in the Case at Bar Undermine Confidence in the Judicial Process.*

In *Boddie* v. *Connecticut*, 401 U.S. 371, 377 (1971), Mr. Justice Harlan wrote for the Court that "[p]rior cases establish, first, that due process requires, at a minimum, that absent a countervailing state interest of overriding significance, persons

forced to settle their claims of right and duty through the judicial process must be given a meaningful opportunity to be heard". In *Boddie* (401 U.S. at 374-375), this Court reviewed "the centrality of the concept of due process" in the operation of a "regularized, orderly process of dispute settlement" by the courts or other quasi-judicial official bodies and stated that "[w]ithout this guarantee that one may not be deprived of his rights, neither liberty nor property, without due process of law, the State's monopoly over techniques for binding conflict resolution could hardly be said to be acceptable under our scheme of things".

In the case at bar, the petitioners were not given a "meaningful opportunity to be heard", because the District Court judge failed to read or consider a substantial amount of their evidence before deciding the case against them. The conclusion by the First Circuit that there was evidence in the "full record" on the basis of which the finding of the District Court judge would be "amply supported" (882 F.2d at 5, App. at 9) is beside the point. Such speculation as to what Judge Caffrey might have found after reading the deposition testimony does not excuse his failure to do so.

In finding the facts without considering all the evidence, the District Court judge did not follow the "regularized, orderly process of dispute settlement" essential to the judicial process. Although the deviation most directly affects the petitioners, it is a clear break from the basic requirements of procedural due process to which litigants have traditionally been entitled. The right to a meaningful hearing has been substantially derogated in this case. Any significant repetition will erode public confidence in the courts. This Court should not tolerate the procedure, by which the judge in this case found facts without first considering all the relevant evidence. Failure to correct the error now would advance the unacceptable procedure employed, to the detriment of public confidence in the basic fairness of the judicial system.

3. *Appellate Review for Clear Error Did Not Render the Error Harmless.*

The First Circuit, in holding that the District Court judge had made a finding of fact reviewable only for clear error, ignored the procedural unfairness at trial. The Court of Appeals, without any discussion whatsoever, inexplicably rejected Barrett and Crittenden's argument that the District Court judge's conclusion ("plaintiff has failed to prove that the company had an unreasonably small capital at a crucial time") was a ruling of law and that this conclusion could not have been a finding of fact because, at the time it was made, the District Court judge had not read the transcripts of the deposition testimony (Reply Brief at page 1). It should be noted that if (as Barrett and Crittenden argued) the District Court's ruling had been a ruling of law on the sufficiency of the evidence, its error in not reading the evidence, would have been made harmless by appellate review *de novo* (the scope of review on questions of law) (*Pierce* v. *Underwood*, 487 U.S. 552, 108 S.Ct. 2541, 2546 [1988]). The First Circuit's review for clear error ("A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with a definite and firm conviction that a mistake has been committed" [*United States* v. *United States Gypsum Co.*, 333 U.S. 364, 395 (1948)] is no substitute for a review *de novo* (on a review *de novo*, the sufficiency of the evidence to support a finding being a question of law, both the reviewing court and trial court view all the evidence, together with all logical inferences derivable therefrom, in the light most favorable to the non-moving party). See *United States* v. *Forness*, 125 F.2d 928, 942-943 (2d Cir. 1942), which this Court cited with approval in *United States* v. *Crescent Amusement Co.*, 323 U.S. 173, 185 (1944).

4. *The Error Is Determinable from the Record.*

Besides concerning an issue of procedural due process which has general significance to the trial of all cases by judges without juries, the case at bar is unusual because the trial judge's lack of opportunity to read the deposition transcripts may be determined by this Court from the record. Judge Caffrey did not leave the bench (apart from one five-minute recess) between the time the deposition evidence (258 pages of testimony and 16 exhibits) was admitted unread into evidence and the time the judge made his oral finding shortly thereafter (the testimony of the final two witnesses is transcribed on 36 pages and argument on the motion to dismiss on 6 pages). A failure to consider evidence, such as occurred in the case at bar, would usually not be determinable from the record.

5. *The Evidence Not Considered Bore on the Subject Matter of the Findings.*

The case at bar is also unusual because of the amount of relevant evidence which the factfinder did not consider. Stanley Finer was a vice president of Continental in charge of trying to collect on a number of bad loans made to Eastern's parent and to one of the parent's owners. Bank personnel had devised a "game plan" to get "our arms around all available assets". Finer knew that Eastern had $2,000,000 in regulatory capital at Continental, and one of his aims was to get that money for the bank. He, in fact, had participated in the actual transfer of the $2,000,000 to Continental. His testimony permitted the inference that Eastern had no liquidatable assets after this transfer. His testimony about the deplorable condition of Eastern's financially "hemorrhaging" parent also provided a foundation for concluding that Eastern's June, 1984 financial statements (introduced at trial during the testimony of other witnesses)

substantially overstated its post-transfer assets by carrying at face value a $421,527 receivable supposedly due to Eastern by the parent.

William Van der Weele had been Eastern's president and chief financial officer until February, 1984. Thereafter, he continued to oversee Eastern's financials until sometime after May. Van der Weele had prepared or helped prepare two financial statements, one as of March 31, 1984, and the other as of May 31, 1984. Van der Weele discussed these statements at some length, confirming that a $2,000,000 capital withdrawal in May had been paid to Continental, that this withdrawal and a $170,000 operating loss in April and May had resulted in Eastern's liabilities exceeding its assets by $264,238.05 and had produced a $1,217,000 deficit in the minimum amount of net capital required by the regulatory authorities for Eastern to do business. After discovery, Van der Weele and Eastern's president agreed that "capital" had to be put back into Eastern in order to restore financial compliance and keep Eastern in business. His testimony in and of itself permits the conclusion that the transfer to Continental caused Eastern to become insolvent without sufficient regulatory capital to stay in business.

6. *The Issue Presented to This Court Was Timely Raised to the First Circuit.*

Judge Caffrey's ruling that petitioners had not proved an unreasonably small capital at a crucial time on its face seems clearly to be a ruling of law on the sufficiency of the evidence. In their brief on appeal, petitioners so framed the issue presented (Brief at page i): "Whether the Trial Court erred in ruling that the plaintiffs failed to prove that Eastern Capital Corporation had an unreasonably small capital at a crucial time".

They argued that Judge Caffrey had made a mistake of law in construing June, 1984 (when Eastern went out of business) to have been a "crucial time" for determining the reasonableness of capital and that the evidence showed that the capital remaining immediately after the transfer on May 16, 1984 was unreasonably small. In stating the case, they mentioned that Judge Caffrey had not read the depositions (Brief at pages 28-29).

In Continental's Brief on appeal, although it did not make its own statement of the issues presented for review or specifically dispute the statement that the trial judge had not read the depositions (see F.R.App.P. 28(b) providing that an appellee's brief shall contain a statement of issues and a statement of the case if appellee is dissatisfied with appellant's statements), Continental did make the argument that "[t]he district court's finding that Barrett and Crittenden failed to prove that Eastern Capital had an unreasonably small capital under Section 5 of the UFCA is a finding of fact" (Continental's Brief at page 20).

In a reply brief, Barrett and Crittenden responded to this argument pointing out that the trial judge's conclusion could not have been a finding of fact because he had not read the Finer and Van de Weele depositions. Petitioners likened the ruling to another ruling by Judge Caffrey, where he had dismissed a case pursuant to F.R.Civ.P. Rule 41(b) because plaintiffs had failed to prove a *prima facie* case. *D.P. Apparel Corp.* v. *Roadway Express, Inc.*, 736 F.2d 1 (1st Cir. 1984). Petitioner also compared the ruling to the rulings reviewed in *Crawford* v. *Northeastern Oklahoma State University*, 713 F.2d 586, 587-588 (10th Cir. 1983) and *Ray* v. *Foreman*, 441 F.2d 1266, 1269 (6th Cir. 1971) where Rule 41(b) dismissals without subsidiary findings of fact were held to have been rulings of law. Barrett and Crittenden argued that "the ruling of the district court in the case at bar frames the question

whether the plaintiffs had made a *prima facie* case . . . judged by the correct legal elements of a *prima facie* case." (Reply Brief at pages 4-5).

In holding that the District Court's conclusion was a finding of fact, the First Circuit referred to none of the points made in the reply brief and egregiously misstated Barrett and Crittenden's position on appeal to be "that the district court must have clearly erred [in making this finding of fact]" *Barrett* v. *Continental Illinois Nat. Bank & Trust, supra*, 882 F.2d at 4, App. at 6.

In petitioning for rehearing, Barrett and Crittenden pointed out that the First Circuit had not addressed their argument "that the trial court's ruling could not have been a factual finding because the factfinder had not considered all the evidence and, thus, had not been in a position to decide the case on the merits". (Petition for Rehearing at page 3). They reviewed the facts in detail and discussed legal authority for their argument, including *Mathews* v. *Eldridge*, 424 U.S. 319, 334 (1976), concluding that the trial judge had deprived them of their Fifth Amendment right to due process of law by deciding the case without reference to the depositions of the out-of-state witnesses.

The petitioners do not believe that they were fairly on notice that they had suffered a constitutional deprivation until the decision of the First Circuit held that the trial judge had made a finding of fact. Until that time, they consider themselves fairly justified in the belief that Judge Caffrey had made a ruling of law, reviewable *de novo* on appeal. For this reason, they submit that their specific constitutional argument was timely, even though first made on petition for rehearing. Compare *Hoover* v. *Ronwin*, 446 U.S. 558, 574 n.25 (1984), where a constitutional argument, first raised in a response to a motion for rehearing, was one which could have been made in the initial brief.

The petitioners also submit that the argument in their reply brief (i.e., that Judge Caffrey could not have made a factual finding because he had not read the evidence) contained obvious constitutional implications. The First Circuit's erroneous perception that petitioners agreed with Continental's argument that a factual finding had been made and the First Circuit's failure to address any of the arguments to the contrary in the reply brief may be construed as a rejection of these arguments on their merits. A holding that there is no error when a trial judge makes findings of fact without reading the evidence would squarely frame the obvious constitutional question for review by this Court. Such a holding is implicit in the First Circuit's decision. Hence, for this reason also, petitioners consider the question to have been timely raised and to be properly before this Court.

Conclusion.

The petitioners respectfully conclude that this petition for certiorari should be granted.

Respectfully submitted,

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January 18, 1990

APPENDIX

Table of Contents.

Opinion of the Court of Appeals	A1
Hearing and Decision by District Court on Motion to Dismiss	A11
Judgment of the Court of Appeals	A16
Order Denying Rehearing	A17
Judgment of the District Court	A18

APPENDIX

Opinion of

United States Court of Appeals
For the First Circuit

No. 89-1151

MICHAEL D. BARRETT and
G. LAMAR CRITTENDEN, JR.,
Plaintiffs, Appellants,

v.

CONTINENTAL ILLINOIS NATIONAL BANK
AND TRUST COMPANY,
Defendant, Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS
[Hon. Andrew A. Caffrey, *Senior U.S. District Judge*]

Before
Breyer, Reinhardt,* and Torruella,
Circuit Judges.

Alexander Whiteside with whom *Putnam, Bell & Russell* was on brief for appellants.

Richard E. Simpson with whom *Garrett B. Johnson, Kirkland & Ellis, Rudolph F. Pierce, Joel R. Leeman* and *Goulston & Storrs, P.C.*, were on brief for appellee.

August 10, 1989

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*Of the Ninth Circuit, sitting by designation.

REINHARDT, *Circuit Judge*:

Appellants Michael Barrett and G. Lamar Crittenden appeal from an order of the district court dismissing their action against Continental Illinois Bank & Trust Co. of Chicago ("Continental"). While the situation which gave rise to Barrett and Crittenden's suit is an intricate one, we can limit our discussion substantially inasmuch as the basis for our decision is relatively uncomplicated. We affirm the district court.

I.

Barrett and Crittenden were two of the owners of a commodity trading house known as Eastern Capital Corporation ("Eastern"). Eastern appears to have been perennially short of cash and to have had repeated difficulty meeting federally-imposed minimum capital requirements. In December 1982, with the government threatening to shut the trading house down, Eastern turned to a Chicago-based financier, Michael Maduff, who agreed to purchase all of Eastern's stock for $1000 and to infuse the necessary capital into Eastern. In return, Eastern's principals, including Barrett and Crittenden, received an option to repurchase the stock several months later for $51,000 plus the amount of any unrepaid capital contributions made by Maduff.

What happened next is not precisely clear, although it is uncontroverted that, on February 14, 1984, Maduff and Eastern's former owners entered into a new arrangement. Barrett and Crittenden, no doubt still smarting from old wounds, assert in the strongest terms that they made the new deal only because Maduff had taken "a variety of actions designed to make [their original] repurchase option worthless." This may well be true, but it is of little relevance to the instant action. In any event, relations between Maduff and the former owners continued to worsen. At the same time, the financial health of Eastern began

to deteriorate again. Ultimately, a group of disgruntled ex-principals of Eastern, including Barrett and Crittenden, sued Maduff on a variety of federal securities, as well as state contract and fraud, claims. The parties eventually settled this action. In September 1986, Judge Keeton of the District Court of Massachusetts dismissed the suit, via an order which, after a series of extensions, became final in April 1987.

The following month, Barrett and Crittenden went to court again, this time filing the present suit, initially in Massachusetts state court, against Continental. The present action focuses exclusively on a transaction in which Eastern, apparently at Maduff's behest, transferred approximately $2 million to Continental in May 1984. Barrett and Crittenden claim that this transaction left Eastern with an "unreasonably small capital" and was therefore a fraudulent conveyance under section 5 of the Uniform Fraudulent Conveyance Act ("UFCA"), M.G.L. 109A § 5.[1] Specifically, the pair contends that the transfer left Eastern without assets sufficient to cover various claims they held against the corporation.

Continental removed the suit to federal district court under 28 U.S.C. § 1441 and moved for summary judgment. Judge Caffrey at first granted Continental's motion, but, upon a motion for reconsideration, vacated his prior order and allowed Barrett and Crittenden to go to trial on their "unreasonably small capital" theory. *Barrett v. Continental Ill. Nat. Bank & Trust Co.*, 695 F. Supp. 66 (D. Mass. 1988). Trial began, without a jury. At the close of the plaintiffs' case, Continental moved for dismissal, alleging that Barrett and Crittenden had failed to prove that Eastern was left with an unreasonably small

[1] Section 5 provides:

Every conveyance made without fair consideration when the person making it is engaged or is about to engage in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent as to creditors and as to other persons who become creditors during the continuance of such business or transaction without regard to his actual intent.

capital by the challenged transfer. Alternatively, Continental contended that the current suit was barred by res judicata on the theory that the dismissal of the suit against Maduff, in which Barrett allegedly had attempted to recover the value of certain claims he held against Eastern, barred a later suit on the same claims. Judge Caffrey granted the motion for dismissal on both grounds, ruling:

> First of all, the plaintiff has failed to prove that the company had an unreasonably small amount of capital at a crucial time. Secondly, on res judicata, this has been litigated once. You can't relitigate it.

Barrett and Crittenden appealed.

II.

We turn first to the district court's conclusion with respect to the fraudulent conveyance question.

A.

In order to assess Judge Caffrey's finding that Eastern's capital was not unreasonably small at the time of the transfer, we must sketch with greater detail the state of Maduff and Eastern's finances during the spring of 1984. For Maduff, who appears from the record to have been somewhat free-wheeling in his financial affairs, it was not a pleasant spring. His various enterprises were seriously in debt; Continental, one of his major creditors, was demanding payment on outstanding loans. The $2 million at issue in this case existed initially in the form of certificates of deposit issued by Continental. Maduff transferred these certificates to Eastern to cover its capital requirements upon his purchase of the commodities brokerage. The

certificates matured in May 1984, and, upon their maturation and Continental's demand for repayment, Maduff transferred the $2 million back to Continental.[2]

Eastern's situation in the months prior to May was similarly grave. The record is uncontroverted that, by May 1984, Eastern was a comany winding up its affairs. Negotiations were underway to sell Eastern's only profitable enterprise, a discount brokerage service. A deal to sell this portion of Eastern was consumated on May 17, 1984, one day after the transfer at issue here. Finally, although the record is not completely clear on the point, it does appear that Eastern was insolvent for a short period immediately after the $2 million was transferred. (For reasons that should become clear below, Eastern's solvency on May 16, 1984 does not dispose of the fraudulent conveyance question.) While, as a practical matter, the final May 17 agreement to sell the discount brokerage business held out the promise of new funds sufficient to cover Barrett and Crittenden's claims against Eastern, the proceeds of the sale did not show up on Eastern's balance sheets until the transaction was actually completed, on June 4. Eastern thus appears to have been in violation of federal net capital requirements as of May 31, 1984. Within one business day of discovering the capital shortfall, Maduff and the purchaser of the discount brokerage took several actions which brought Eastern well within the capital requirements. Three days later, the sale of

[2] In describing this transaction, the parties go into minute detail about the corporate structure of the various Maduff corporations, although Eastern's place in the Maduff corporate family is essentially irrelevant to the fraudulent conveyance question. In a nutshell, Eastern, upon its acquisition by Maduff, became a wholly-owned subsidiary of one of Maduff's companies. When Maduff transferred to Eastern the $2 million which he had received from Continental, he did it by "downstreaming" the funds (i.e., transferring them from the parent, down through the corporate family, until they arrived at Eastern). In May 1984, with Continental insisting that the "new" $2 million had to be "traceable" to the "original" $2 million, the money was then "upstreamed" through the same entities, and the funds returned to Continental via a series of bona fide (or at least unchallenged) corporate resolutions.

the discount brokerage further enhanced Eastern's financial position, and the record shows that (at least on paper) Eastern's assets, as of June 30, exceeded $1 million.

B.

As a threshold matter, we must decide how to treat Judge Caffrey's conclusion that Barrett and Crittenden failed to prove that Eastern's capital was "unreasonably small." Continental urges that, inasmuch as the proceeding below was a bench trial with the judge filling the factfinder's role, we should consider the conclusion to be basically a factual finding, subject to review only for clear error. We agree. The judgment about whether Eastern's capital was unreasonably small after the $2 million dollar transfer is a factually-grounded one; accordingly, we shall not set it aside unless clearly erroneous. *See F.P.P. Enterprises v. United States*, 830 F.2d 114, 117 (8th Cir. 1987) (district court's conclusion with respect to fraudulent characteristics of challenged transfers subject to clearly erroneous review). *See also Keyes v. Secretary of the Navy*, 853 F.2d 1016, 1019 (1st Cir. 1988).

Barrett and Crittenden's position is essentially that the district court must have clearly erred, for, they claim, Eastern's apparent insolvency on May 16, 1984 — the precise date of the transaction at issue — conclusively establishes that the transfer left Eastern with an unreasonably small capital within the terms of § 5 of the UFCA. We do not believe the matter to be so simple, nor is the result Barrett and Crittenden seek compelled by the cases they cite. The case upon which the pair relies most heavily is *United States v. Gleneagles Inv. Co., Inc.*, 565 F. Supp. 556 (M.D. Pa. 1983), *aff'd sub nom., United States v. Tabor Realty Corp.*, 803 F.2d 1288 (3d Cir. 1986).[3] Barrett and Crittenden correctly note that, at several

[3] The Third Circuit did not address the *Gleneagles* court's treatment of the UFCA § 5 issue. Consequently, we discuss the case solely in reference to the district court opinion.

places in its opinion, the *Glenagles* court stated that its § 5 analysis would deal with the capital condition of the corporation as of the specific date of the allegedly fraudulent conveyance, in that case November 26, 1973. *See Gleneagles*, 565 F. Supp. at 573, 578. At the same time, when it actually performed its "unreasonably small capital" analysis, the court looked to a decidedly more expansive period of time, ultimately determining that "[b]oth before the November 26, 1973 transaction as well as thereafter, the transferor did not have the capital resources it needed to carry on its business." *Id.* at 580. It thus appears that in *Gleneagles*, although it seemed to focus on the specific date of the transaction, the court actually took into account the corporation's capital levels during a period extending in both directions from that date. We believe that the proper application of § 5 requires a court to examine a company's capital throughout a reasonable period of time surrounding the precise date of a challenged transfer. This approach avoids the risk of ascribing undue weight to the state of a company's balance sheet on a particular day, and allows the court to make a realistic assessment of the impact of a transfer on a company's ability to conduct its affairs.

In addition, the *Gleneagles* court took into account what "resources [the corporation] needed to carry on its business" when it examined whether the corporation's capital was unreasonably small. "Unreasonably" is clearly a relative term and demands, for purposes of § 5, the sort of relative, contextual judgment which looks to both the ends served by § 5 and the overall state of affairs surrounding the transferor corporation and the challenged transfer itself. The critical inquiry when considering whether a transfer or conveyance has left a company with an unreasonably small capital is, therefore, one that weighs raw financial data against both the nature of the enterprise itself and the extent of the enterprise's need for capital during the period in question. *See Matter of Atkinson*,

63 B.R. 266, 269 (Bankr. W.D. Wisc. 1986) (for violation of § 5, capital must be unreasonably small "relative to the nature of the venture").

This approach appears to be essentially the one followed in Massachusetts. In *Widett* v. *George*, 336 Mass. 746 (1958), the Massachusetts Supreme Judicial Court held that questions concerning the adequacy of capital after a challenged transfer had to be "judged prospectively" from the date of the transfer. 336 Mass. at 751. Under the *Widett* approach, a court begins its analysis with the transfer and then examines the relationship, if any, between the amount of capital remaining in the business in the period after the transfer and the business' ability to continue operations during that period in the same manner as it conducted them before the transfer. In our view, this is the most sensible construction of § 5.

In this instance, we address a somewhat unusual case, for the challenged transfer was made by a company that was indisputably going out of business at the time the transfer was made. We note that some courts have observed that the basic purpose of § 5 is to "prevent an undercapitalized company from being thrust into the market place to attract unwary creditors to inevitable loss," *Wells Fargo Bank* v. *Desert View Building Supplies*, 475 F.Supp. 693, 696 (D. Nev. 1978), *aff'd*, 633 F.2d 225 (9th Cir. 1980), and have accordingly concluded that the section's application is "limited to businesses that are continuing on some scale." *See, e.g., In re Pinto*, 89 B.R. 486, 501 (Bankr. E.D. Pa. 1988). While we agree with the *Wells Fargo* court's characterization of the most significant end served by § 5, we decline to adopt a per se rule which would preclude the application of the section to any transfer made by a company winding up its affairs. There may well be situations, of which we need not speculate here, in which § 5 would present a worthy creditor's only redress for a palpably fraudulent transfer. At the same time, however, the

fact that a company is in the process of going out of business is ordinarily the critical element in a court's contextual assessment of the "reasonability" of the company's capital for the post-transfer period.

Thus, when we examine the $2 million transferred from Eastern in May 1984, it is apparent that Judge Caffrey did not clearly err in concluding that Barrett and Crittenden failed to prove a violation of § 5. Eastern was an entity winding up its affairs; indeed, it entered into an agreement to sell its ony profitable business within a day of the transfer. There were no "unwary [prospective] creditors" who were about to invest in Eastern, only to suffer "inevitable loss." *See Wells Fargo*, 475 F.Supp. at 696. In short, when the transfer is placed in the broader context of the operations Eastern contemplated during the spring of 1984, the $2 million payment to Continental does not appear to us to have left the company with an "unreasonably small capital."

Eastern did, of course, have its creditors, Barrett and Crittenden among them. And Eastern may have been technically insolvent, possibly for as long as two weeks, after it paid back Continental's $2 million. Nevertheless, Judge Caffrey's conclusion that Barrett and Crittenden failed to show that Eastern's capital was unreasonably small at "a crucial time" is one amply supported by the record, and one we will not overturn as clear error here. Eastern was unquestionably solvent by June 1, 1984, and had sufficient assets to cover all of Barrett and Crittenden's potential claims against it by that time. Indeed, upon learning at trial just how substantial Eastern's assets were as of June 30, 1984, Crittenden reflected that he "regret[ted] that [he] didn't move for an attachment [then]."

With admissions such as this from one of the plaintiffs, and based on the full record as it existed at the close of the plaintiff's case, we will not disturb the conclusion of the district court that Barrett and Crittenden failed to prove a violation of § 5

of the Uniform Fraudulent Conveyance Act. Accordingly, the judgment of the district court is

AFFIRMED[4]

[4] In light of our conclusion that the district court's judgment can be sustained on the first ground asserted by Continental in its motion to dismiss, we express no view on the question whether the court below correctly held that Barrett and Crittenden's suit against Continental was barred by doctrines of res judicata.

A11

United States District Court
District of Massachusetts

C.A. No. 87-1478C

MICHAEL D. BARRETT, and
G. LAMAR CRITTENDEN, JR.
Plaintiffs,

vs.

CONTINENTAL ILLINOIS NATIONAL BANK AND TRUST COMPANY OF CHICAGO,
Defendant

HEARING AND DECISION ON MOTION TO DISMISS
(Caffrey, S.D.J.)
February 3, 1989

MR. WHITESIDE: Your Honor, the plaintiffs rest.

MR. JOHNSON: Your Honor, I would like to move, pursuant to Rule 41(b), for dismissal of the plaintiffs' case. Their evidence shows absolutely no right to recover, primarily because their own evidence demonstrates that there was not unreasonable capital in the company. This company was not in business as of June 1st. Their own testimony indicates that the business had all been sold by June 1st.

More importantly, the evidence all indicates that the company was in capital compliance on or after June 4th for the entire month of June, entire month of July — had plenty of cash — several-hundred thousand in cash. It had over a million dollars in assets. That is not unreasonably small capital for a company that is not intending to do any business, but merely in a liquidation mode under the law.

Secondly, the evidence shows that Michael Barrett has no right to recover because he is not a creditor of the company. Deloitte, Haskins & Sells, the auditors for the company, beginning in September of 1983, wiped those loans off the books, if

they ever were properly on the books. All reports that were filed after that showed no such liability. As of the date of the challenged transfer of CDs from the account of Eastern Capital, those loans were not liabilities of the company. That transfer had zero impact on those loans. They had been gone for a long time.

Another reason why Michael Barrett has no claim and they have established it is that they have established through their own proof that Michael Barrett already sued for this recovery in a lawsuit that they dismissed with prejudice against them and without recovery. They cannot sue for that again. Their exhibit that they admitted, Plaintiffs' Exhibit 7 in this case, has at the end a prayer for relief in that litigation, and it says on Page 24, Paragraph A: Defendants must cause all existing obligations of Eastern Capital Corporation to the plaintiffs, less any amounts forgiven pursuant to Subparagraph B, to be paid to the plaintiffs. In other words, they already sued for this money. They sued Maduff and the Maduff Group to collect the money and they lost. Paragraph B: Defendants must forgive all existing obligations of the plaintiffs to Eastern Capital Corporation. Well, we know what that is, too. They sued to get that $813,000 back that Maduff said, "You owed me" under the December 6th agreement," and Deloitte, Haskins and Sells used to wipe the loans off the books — both those aspect of this — they are independent of each other — they are independent of each other. Both of them say that these plaintiffs sued for this same money. They litigated that case for years. That case was dismissed. It has been stipulated with prejudice to them. They cannot come back and sue the Continental Bank on that same cause of action. And that is what this case is all about.

In short, they have not made out a case. They haven't made out a case under the statute that Eastern Capital had unreasonably small capital. They haven't, because the momentary shortfall was cured overnight.

Eastern Capital was in compliance for months after it, and under the law that is not unreasonable.

For that reason I am moving to dismiss their case at the close of their evidence.

THE COURT: I will hear the plaintiffs.

MR. WHITESIDE: Your Honor, I would suggest that when you look at the cure and you debit the $80,000, just doing that, and you recompute required net capital, you will find that you are short.

Mike Maduff made a mistake. Obviously, he wanted to, he just wanted to get rid of his securities accounts, and you heard Miss Lewis say that you can't move the accounts until you have cured the deficiency. So I would suggest that when Mr. Francis testified that there was $80,000 of assets that shouldn't have been there, that that must be factored in.

I also suggest, your Honor, that you have to figure in what their Complaint is and I think doing that you find the net capital — you find a deficiency in equity and you find a net capital deficiency to boot. Just on the basis of the $80,000. It was stop gap. Eastern was going out of business. It was not the same business after they sold all their business. It was sitting there, and I think it is farfetched to believe that that money stayed in Eastern very long.

He said the money was in there for months, but you will recall, your Honor, you struck the exhibit which the only person who identified it was Mr. Crittenden, who knew nothing about it. He didn't know whether or not Eastern had any money in July, and, in any event, that has been stricken.

The other Focus Report that he identified fails to mention, fails to carry over the $2,000,000 deduction from equity, which it was required to carry over under, you know, just under accounting.

It began in April. It ended in June. There was a $2,000,000 withdrawal from equity and it is not reflected in there. It is not there. No one can ask about it. It simply is incorrect.

But I suggest that there is a reason to assume that Eastern, which had just cleared out everything that it had and was awaiting for the transfer of its assets so that it could close its accounts and that would be the end of it, I think it is unreasonable to assume that that money stayed there any longer than was necessary. It was the completion of a liquidation which was, you will see when you read Mr. Finder's transcript — it was the completion of a liquidation that was begun when Michael Maduff walked into Continental's office and said: "My companies are hemorrhaging. I can't go on." He used the word hemorrhaging. "My companies are hemorrhaging," and we have got to do a liquidation, and Continental can draw up a plan for the liquidation of Eastern, and I suggest, your Honor, that the situation in June has not been fairly proved to be that of anything but an unreasonably small capital. I also believe that when the statute says, talks about an unreasonably small capital during the continuance of the business, it does not mean that you can go down the line and wait until it ceases its business, and then look at the reasonableness of the capital. I think that Eastern was a broker-dealer. I think that the reasonableness of its capital has to be looked at in that context.

The Silverman case — I would say this — there was a dismissal and the defendants were Maduff Group, Maduff and Sons, Michael Maduff and Robert Rosenthal, and we agree that all claims between the parties regarding this have been concluded by them. We also suggest that the two judgments, which have been entered against Eastern, are valid and binding judgments and are not precluded by the Doctrine of Estoppel or any other doctrine, and that the Silverman case — certainly the only thing the Silverman case does in this case is it forecloses that claim that there is an $813,000 credit.

So I would suggest, your Honor, that, far from winning the Silverman case, the Maduff Group gave up its $813,000 claim. I suggest that the Maduff Group lost the Silverman case, and it is far from the bank at this point to relitigate it now.

So I take quite an opposite view on what the effect of the Silverman case is in these circumstances.

I would ask that motion be denied.

THE COURT: All right.

MR. JOHNSON: Nothing further, your Honor.

THE COURT: All right.

The motion is allowed on the grounds that Mr. Johnson spelled out: First of all, the plaintiff has failed to prove that the company had an unreasonably small amount of capital at a crucial time. Secondly, on res judicata, this has been litigated once. You cannot relitigate it.

So the Motion for Judgment for the Defendant is allowed.

MR. JOHNSON: Thank you, your Honor.

MR. WHITESIDE: Thank you, your Honor.

(Whereupon the trial was concluded and court was adjourned.)

United States Court of Appeals
For the First Circuit

No. 89-1151

MICHAEL D. BARRETT and
G. LAMAR CRITTENDEN, JR.,
Plaintiffs, Appellants,

v.

CONTINENTAL ILLINOIS NATIONAL BANK
AND TRUST COMPANY,
Defendant, Appellee.

JUDGMENT

ENTERED: AUGUST 10, 1989

This cause came on to be heard on appeal from the United States District Court for the District of Massachusetts, and was argued by counsel.

Upon consideration whereof, it is now here ordered, adjudged and decreed as follows: The judgment of the district court is affirmed.

By the Court,

Francis P. Scigliano
Clerk

United States Court of Appeals
For the First Circuit

No. 89-1151

MICHAEL D. BARRETT and
G. LAMAR CRITTENDEN, JR.,
Plaintiffs, Appellants,

v.

CONTINENTAL ILLINOIS NATIONAL BANK
AND TRUST COMPANY,
Defendant, Appellee.

Before
Campbell, *Chief Judge*,
Bownes, Breyer, Torruella, Selya and Reinhardt,*
Circuit Judges.

ORDER OF COURT

Entered: October 20, 1989

The panel of judges that rendered the decision in this case having voted to deny the petition for rehearing and the suggestion for the holding of a rehearing en banc having been carefully considered by the judges of the Court in regular active service and a majority of said judges not having voted to order that the appeal be heard or reheard by the Court en banc,

It is ordered that a petition for rehearing and a suggestion for rehearing en banc both be denied.

By the Court,

Francis P. Scigliano
Clerk

*Of the Ninth Circuit, Sitting by Designation.

United States District Court
District of Massachusetts

MICHAEL D. BARRETT, ET AL.

v.

CONTINENTAL ILLINOIS BANK AND TRUST CO., INC.

JUDGMENT IN A CIVIL CASE

CASE NUMBER: 87-1478-C

☐ **Jury Verdict**. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☒ **Decision by Court.** This action came to trial before the Court. The issues have been tried and a decision has been rendered. By the Courts Allowance of Defendant's Oral Motion to Dismiss Pursuant to Rule 41(b).

IT IS ORDERED AND ADJUDGED Judgment for the Defendants.

February 7, 1989
Date

/s/ Robert J. Smith, Jr.
Clerk

/s/ Lisa M. Veneto
Deputy Clerk